

University of Mississippi

eGrove

Association Sections, Divisions, Boards, Teams

American Institute of Certified Public
Accountants (AICPA) Historical Collection

1999

Proposal to Interpret ISB No. 1 re: For Discussion at ISB Meeting of November 19, 1999

Independence Standards Board

Follow this and additional works at: https://egrove.olemiss.edu/aicpa_assoc



Part of the [Accounting Commons](#), and the [Taxation Commons](#)

Proposal to Interpret ISB No. 1 re:

For Discussion at ISB Meeting of November 19, 1999

Proposal for the ISB to Interpret its Independence Standard No. 1, "Independence Discussions with Audit Committees" as to Audits Performed by "Secondary Auditors" for Subsidiaries of an SEC Registrant

The Question

In many situations, subsidiaries or investees of an SEC registrant are audited by a firm other than the primary auditor.

- **How does ISB Standard No. 1 apply to these secondary auditors, if at all, and what related responsibility does the primary auditor have?**

Background

In January, 1999, the Board issued ISB Standard No. 1, "Independence Discussions with Audit Committees." In paragraph 1, the Standard states: "This standard applies to any auditor intending to be considered an independent accountant with respect to a specific entity within the meaning of the Securities Acts (the Acts) administered by the Securities and Exchange Commission."

It is clear that when a subsidiary or investee is itself a registrant, the secondary auditor must comply with ISB No. 1. However, ISB No. 1 does not directly address the question of this document, nor does the staff recollect any discussions of this issue as ISB No. 1 originally was debated.

The ISB staff believes this issue should be addressed by the Board as a Board Interpretation because:

- It is a relatively common issue which already has arisen in practice and which is worth interpreting;
- There is no consensus view on this issue; and
- The document for which implementation is requested is a recent Standard issued by the ISB.

Applicability

- To the secondary auditor

This interpretation applies to the auditor of a subsidiary or investee of an SEC registrant ("secondary auditor") who is requested by the registrant's primary auditor to confirm its independence in accordance with US generally accepted auditing standards (GAAS) and SEC and ISB rules.

This interpretation would normally not require a secondary auditor which is a member of the primary auditor's international organization to separately comply with ISB No. 1. This is so because the primary auditor would not ask such a secondary auditor to confirm its independence with respect to the specific client if the primary auditor is satisfied with the controls maintained and enforced (by the international organization or otherwise) to require independence of SEC audit clients generally. This is consistent with current practice whereby the primary auditor does not express reliance on the audit of even a highly material subsidiary performed by an associated firm because of its overall satisfaction with the other firm's quality controls. In other words, even though there may be separate legal structures, the policies and procedures in place allow members of such international organizations to report as if they were all part of one firm.

- To the primary auditor

This interpretation also applies to the primary auditor if such auditor requests confirmation that the auditor of the other entity is independent in accordance with GAAS and SEC and ISB rules.

- Note: The following implementation guidance focuses primarily on the requirements of the secondary auditor, although certain alternatives also are presented for procedures of the primary auditor. Some believe that the primary auditor should have no required ISB No. 1 responsibility with respect to that secondary auditor, or that other responsibilities lesser than those suggested in the following alternatives would be appropriate. The holders of these views suggest that the Board also consider *these additional alternatives* of lesser primary auditor involvement.

Alternative Implementation Guidance for Consideration by the Board

The following three alternative proposed interpretations are presented for Board consideration, along with their supporting rationale.

Interpretation Alternative A - Unless the subsidiary/investee itself also is a registrant, there is *no* ISB No. 1 requirement on the secondary auditor. However, the primary auditor should consider its degree of reliance upon the secondary auditor, any independence matters relating to the secondary auditor of which it has become aware, and whether those matters should be deemed "relationships...that in the auditor's professional judgment may reasonably be thought to bear on independence" under ISB No. 1 and, therefore, considered in its letter to the parent company audit committee (or to be otherwise communicated).

- Rationale - Application of ISB No. 1 procedures at a level below that of the parent company was not envisioned during the standard-setting process, with some having a presumption that it generally would be necessary only at the parent level. Supporters also believe that requiring application at subsidiary levels could result in numerous such instances, and there would be incremental corporate governance costs. They also believe that such a requirement could create a disincentive for hiring a different audit firm at the subsidiary level, and such a requirement should only be imposed if the benefits to auditor independence are clear, which they believe is not true in this case. Such subsidiary ISB No. 1 reviews infrequently would be meaningful, and when they would be, the primary

auditor's judgmental evaluation proposed and described above already would provide appropriate controls. In addition, especially in foreign countries, subsidiary boards (and audit committees, if they exist), may not have the requisite familiarity with ISB No. 1 to engender the benefits intended by the Standard.

Interpretation Alternative B - When the primary auditor expressly refers in its audit report to reliance on the work performed by the secondary auditor, then the secondary auditor should be required to comply with ISB No. 1 as though that entity were itself a registrant. Also, the primary auditor should obtain a copy of the secondary auditor's ISB No. 1 letter to its client's audit committee, consider reading the subsidiary board minutes for reactions to that letter, make its own determination (as would the audit committee) of the effects of the matters reported on the secondary auditor's independence, and consider the secondary auditor's letter to determine whether in its judgment any described relationships should be discussed with the parent company's audit committee.

- Rationale - This alternative is viewed as a practical compromise. It requires complete local compliance with ISB No. 1 in those cases where the primary auditor explicitly refers in its report to its reliance on the secondary auditor, thus capturing independence relationships with a significant likelihood of being of consequence to the parent company. At the same time, it exempts from local application of ISB No. 1 those much more numerous cases where the secondary auditor's independence relationships generally are considered unlikely to be of consequence to the parent.

Interpretation Alternative C - On each occasion when the primary auditor considers it necessary to request confirmation of a secondary auditor's independence in accordance with US GAAS and SEC/ISB standards, then the secondary auditor is required to comply with ISB No. 1 requirements in full for the subsidiary/investee on which it reports as though that entity were itself a registrant. Also, the primary auditor is required to perform the procedures listed in the second sentence of Alternative B above.

- Rationale - The requesting of such independence confirmation by the primary auditor is a clear indication that there is some reliance on the work of the secondary auditor. Furthermore, if the secondary auditor is asked to confirm its independence under SEC and ISB rules, then it needs to comply with *all* of those rules, including ISB No. 1. The primary auditor is relying on that confirmation, and should make an assessment of the secondary auditor's independence in the same way an audit committee is expected to. It should also report to the parent audit committee appropriate detail or summaries of the reports of the secondary auditors.

[Retrieve the Word Document](#)

Return to the [Main Page](#).